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Financial Markets

Irving Trust

Irving Trust Company
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Economic Research &
Planning Division

Friday
(Noon)

Nov. 7, 1980

To put it mildly, the financial markets this week were panicky and rumor-filled. It is hard to imagine a scenario that could have been much more unsettling. Even the positive effect on the markets of the election results was quickly wiped out as market participants focused their attention on other matters.

Obviously, the main source of market apprehension was the rapidly rising trend of the Federal funds rate and other market rates. In the space of a little more than a week, the Federal funds rate has backed up by about 200 basis points, to a level well in excess of the presumed 14% top of the Fed's acceptable range for the rate. As if that were not sufficient cause for concern, it occurred during the week of the Treasury's regular quarterly refunding operation, when about $8 billion of intermediate- and long-term securities were being auctioned. With retail investor demand virtually absent, dealers were understandably apprehensive about bidding for the securities, and the record high rates set in the auction reflected that fact. To top it off, rumors abounded that the Fed would tighten the monetary policy screws still further, including an increase in the discount rate to 12% or 13% from its present 11% level.

But the jury is still out on all of this. Despite assertions to the contrary in some quarters, there is little tangible evidence that the Fed has undertaken an abrupt tightening of its policy stance. On the other hand, there are abundant indications of temporary distortions that could account for much of the upward pressure on the funds rate. Last week, we noted that extremely thin dealer positions in Treasury and agency securities could have created difficulties for the Fed in adding all of the reserves called for by its projections. Some tentative confirmation of this view was seen this week in the sharp drop of Treasury balances at the Federal Reserve Banks. A reduction in such balances injects reserves into the banking system, and our best guess is that in large part it was undertaken deliberately in order to alleviate the Fed's reserve-supplying problem.

Another source of distortion in the reserves market during the week was the election. The Tuesday holiday meant that banks which normally cover their reserve needs in the funds market on Monday and Tuesday had to do it all on Monday, and that naturally made them more aggressive in bidding for funds. The result: upward rate pressure. In addition, banks have done relatively little writing of CDs in the unsettled market, and that also should have increased pressure on funds somewhat.

The bottom line is that it is too early to tell whether the Fed has tightened its policy stance. An increase of the discount rate would be a clear signal, of course, but currently it is not obvious that such will occur. In fact, if the discount rate has not been raised by Friday night, it will probably indicate that much of the sound and fury of this week's rate increases represented a distortion--and was perceived as such by the Fed.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	11/7/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors			
with highest credit rating	15.50%	14.50%	15.50%
Effective since	11/6/80		
Discount Rate at Federal Reserve Bank	11.00	11.00	12.00
Federal Funds	15.25	13.88	13.75
Repurchase Agreements	14.00	12.75	12.25
U.S. Treasury Issues			
Bills			
3 months	13.88	12.54	12.50
6 months	14.05	12.65	13.00
1 year	13.80	12.20	12.50
Coupons			
2 years	13.33	13.05	11.89
4 years	13.25	12.85	11.18
7 years	13.00	12.40	11.05
10 years	12.97	12.35	10.75
Long Bond	12.45	12.08	10.30
Negotiable Certificates of Deposit-Secondary Market			
1 month	14.90	13.90	14.20
3 months	14.35	14.40	14.35
6 months	14.10	14.40	14.40
1 year	14.25	14.40	13.70
Banker's Acceptances			
1 month	14.90	13.70	14.00
3 months	14.85	14.40	14.50
6 months	14.30	14.50	14.50
Eurodollar Deposits			
1 month	15.88	14.50	14.75
2 months	16.38	15.00	15.56
3 months	16.50	15.06	15.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	14.00	13.25	10.00
1 month	14.63	13.00	14.00
3 months	13.63	12.50	12.88
Bank Holding Companies			
1 month	14.63	13.38	13.90
Dealer Placed:			
3 months	14.50	13.38	14.25
New AA Corporate Utility Bond	14.63	14.13	11.75
Tax Exempt			
6 month Project Notes	6.50	6.25	6.25
1 year AAA Bond	7.40	6.15	NA
5 year AAA Bond	7.20	7.00	NA
20 year AAA Bond	9.00	8.00	6.75

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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